# Northern Rock avoids £258m compensation bill to UK taxpayers

28/07/2015

**Financial Services analysis: The Court of Appeal has ruled that when a lender uses documentation compliant with the Consumer Credit Act 1974 (CCA 1974) for loans outside that Act's scope, the lending is not regulated by CCA 1974. David Bowden, freelance independent consultant, comments on the implications of the judgment that dealt with misrepresentation, limitation and the future of secured lending.**

## Original news

*NRAM plc v McAdam and another* [2015] EWCA Civ 751, [2015] All ER (D) 248 (Jul)

## What is the background to this case?

NRAM, previously known as Northern Rock plc, is the successor company to which Northern Rock Building Society transferred its business in 1997. This lender got into financial difficulties from August 2007 onwards. On 17 February 2008 it was taken into public ownership and is now indirectly wholly owned by HM Treasury. Since nationalisation it has not undertaken any new lending, but holds a substantial book of historic residential mortgages dating back before nationalisation. NRAM has to administer this secured lending book.

Under CCA 1974, s 77A there is a requirement to send periodic statements to borrowers. These s 77A statements have to contain certain prescribed information. If they do not, then interest is not chargeable during a period of default. The s 77A statements NRAM had historically sent were not compliant. NRAM had compensated borrowers whose lending was clearly within the scope of the CCA because the loan was for less than £25,000. NRAM had another large group of 41,000 borrowers who had used its 'Together' mortgage to borrow sums above this limit, typically £30,000. NRAM disputed any compensation obligation to this group because it said the CCA did not apply to them. The only deficiency with the s 77A statements are they did not state the original amount of credit provided. The borrowers have not suffered any loss as a result of this minor omission.

NRAM brought a claim under the Civil Procedure Rules 1998, SI 1998/3132, Pt 8 to determine if CCA 1974 applied to this group. Two of its customers were joined in the action as defendants. In a reserved judgment of Mr Justice Burton handed down in the Commercial Court on 10 December 2014 (see *NRAM plc v McAdam and another* [2014] EWHC 4174 (Comm), [2015] 2 All ER 340) the lender finally got a ruling on this issue. The judge ruled that NRAM's customers were contracted into, as far as possible, the totality of CCA 1974 protections.

NRAM appealed from this ruling to the Court of Appeal. The appeal was expedited and heard over two days on 28/29 April 2015 by Longmore, Richards and Gloster LJ. In its reserved judgment handed down on 23 July 2015 the Court of Appeal has unanimously overturned the ruling of Burton J on all issues bar one. The Court of Appeal has ruled that where NRAM used documentation compliant with CCA 1974 for loans outside the scope of CCA 1974, the lending is not regulated by CCA 1974. However, the Court of Appeal ruled against NRAM finding that it had made a representation that its loan agreement is CCA 1974 regulated. While such a representation could give rise to a claim in damages under the Misrepresentation Act 1967 (MA 1967) any such misrepresentation claim against NRAM was made over six years ago and is now time-barred under the Limitation Act 1980 (LA 1980).

No application was made by the defendants in the Court of Appeal for a final appeal to the Supreme Court.

## What is the significance of this case?

If NRAM had lost this appeal, it estimated that the compensation bill (which will be paid by UK taxpayers as a whole) would have been £258m with a continuing remediation bill of £2m a month while the technical defaults continue.

The CCA 1974, s 77A requirements were added when the provisions in the Consumer Credit Act 2006, s 6 (CCA 2006) came into force on 1 October 2008. The majority of NRAM's customers took out their loans before these new rights came into force or were contemplated.

## What were the issues the Court of Appeal was asked to address?

In the end, although there were eight grounds of appeal, the Court of Appeal decided that it had to determine the following five issues:

- Is it possible to contract into the provisions of CCA 1974?
- Were the provisions of CCA 1974 incorporated into NRAM's loan agreements?
- Did NRAM agree that its customers were to have some or all of the CCA 1974 protections?
- Did the statutory wording of CCA 1974 mean that NRAM was estopped from denying that its customers had CCA 1974 rights?
- Did NRAM make a representation or warranty that its loan agreements were CCA 1974 regulated when they were not?

## What did the Court of Appeal rule?

On the first four of the five issues, the Court of Appeal ruled in NRAM's favour. On the fifth and final issue, the Court of Appeal ruled that NRAM had made a warranty that its loan agreements were CCA 1974 regulated when they were not. While this could give rise to a claim for damages under MA 1967, any such claim against NRAM was at least six years old and would be time barred under LA 1980. Accordingly, the effect of the Court of Appeal's ruling is that it does not have to pay any compensation to the 41,000 borrowers in this group. In the process, the UK taxpayer has been spared paying a remediation bill of £258m.

### Issue one--contracting in

Lady Justice Gloster gives the judgment of the court to which all members contributed. In it she sets out at some length a plethora of the CCA 1974 provisions which could have applied. These include:

- disclosure of information and statements (CCA 1974, ss 55, 77A)
- agreement formalities (CCA 1974, ss 60, 31)
- copy documents (CCA 1974, ss 62, 63)
- improper execution and court enforcement orders (CCA 1974, ss 65, 127, 135)
- cancellation rights (CCA 1975, s 67), and
- time orders (CCA 1974, s 129)

CCA 1974 contains many provisions emphasising the importance of both regulations made under it and the role of the court in enforcing any regulated agreement. Parties are forbidden from contracting out of CCA 1974 (CCA 1974, s 173). However, Gloster LJ had to determine whether parties can contract into CCA 1974 if the amount of the lending is outside the regulated financial limit. County courts are given exclusive jurisdiction by CCA 1974, s 141 to hear and determine any action by the lender to enforce a regulated agreement or a linked transaction. Gloster LJ ruled:

> 'On the face of it, the 1974 Act has no application to unregulated agreements such as loan agreements for sums in excess of £25,000 made before 6th April 2008.'

However, she said the question whether it is conceptually possible expressly to contract into CCA 1974 was not an easy question to answer. In the end she adopted the comments of Professor Goode in his encyclopaedia, Consumer Credit Law and Practice, where he says:

'Realism compels one to admit that, judicial conservatism being what it is, the reaction of the average County Court Judge is likely to be: 'if they cannot lawfully contract out of [the 1974 Act], they cannot contract into it either'.'

### Issue two--incorporation

Gloster LJ rules that there had been no express incorporation of CCA 1974's provisions in NRAM's customer documentation--here there is a clear overlap with issue one. Having reviewed authorities in other fields on this, in the end Gloster LJ ruled that the incorporation argument proves too much. The provisions as to enforcement are fundamental to

the regulatory scheme envisaged by CCA 1974. If the provisions about enforcement only by order of the court are to be disregarded as inapposite, she asks what is the point of incorporating CCA 1974? The consequence of disregarding those provisions means that the contract is enforceable without an order of the court despite the fact that it has not been properly executed and one of the main purposes of CCA 1974 will be frustrated at the same time as the parties are stating that it is intended to apply.

**Issue three--agreement**

This is the most substantial issue Gloster LJ has to determine and it takes up nine pages of analysis in her judgment. In the process, Gloster LJ rejects the views set out on this in the two encyclopaedias on consumer credit--'Goode' and 'Guest & Lloyd'--that it was possible for parties to agree to incorporate CCA 1974 for non-regulated business.

Gloster LJ says that she cannot agree with Burton J that NRAM's agreement should be construed as including any such term, whether express or implied, that NRAM would treat the borrowers as if they had the protections of the CCA, irrespective of whether such protections applied or not.

Gloster LJ says:

> 'With respect to the views contained in these highly respected text books, it is in our judgment impossible--at least without doing unjustified violence to the language--to construe such statements (for example, "Fixed-sum loan agreement regulated by the Consumer Credit Act 1974" and "This is a Credit Agreement regulated by the Consumer Credit Act 1974. Sign it only if you want to be legally bound by its terms.") as an additional contractual agreement or promise that, even if the agreement was not a regulated agreement, NRAM would treat unregulated borrowers as if they had the benefit of unspecified, but not all, of the statutory protections afforded to regulated borrowers by the Act.'

Gloster LJ said that Burton J had given too much reliance to landlord and tenant law cases cited to him such as *Daejan Properties Ltd v Mahoney* [1995] 2 EGLR 75. She ruled that contrary to the views expressed in 'Guest', she does not consider that this is an appropriate case for the application of the contra proferentem rule. That principle only applies in cases where doubt remains as to the meaning of the term after it has been construed applying the normal principles of construction.

In conclusion, on this crucial issue, Gloster LJ rules that for these reasons Burton J was wrong to conclude that it was a contractual term of the agreement that the borrowers would be treated as if they had the benefit of certain, but not all, of the protections of CCA 1974 conferred upon borrowers under a regulated agreement. She spells out the consequence of this at para [50]:

'In particular he was wrong to conclude that the borrowers had no obligation to pay interest during periods when NRAM had failed to give statements which complied with the form set out in section 77A of the 1974 Act.'

**Issue four--estoppel**

This is dealt with more briefly with Gloster LJ expressing confusion as to precisely what Burton J thought NRAM was estopped from doing. In the end, Gloster LJ says that Burton J was wrong to conclude that, if no relevant contractual term was incorporated in the loan agreement, nonetheless NRAM was estopped on the basis of some sort of contractual estoppel, estoppel by convention or estoppel by representation from denying that the respondents had the benefit of some, but not all, of the protections contained in CCA 1974 and in particular those contained in CCA 1974, s 77A.

**Issue five--warranty**

This is dealt with very briefly because of the limitation defence that NRAM has. However, it is this issue which will cause other lenders to have to make difficult decisions.

Gloster LJ ruled that in her view the relevant statements on any basis amounted to a representation by NRAM that the loan agreement was CCA 1974 regulated and its borrowers were entitled to the protections afforded by it to borrowers under CCA 1974 regulated agreements. NRAM's representation had legal effect in the sense that, if it were false, the NRAM's customer would be entitled to sue NRAM for misrepresentation under MA 1967. Given the context and prominence of the relevant statements, Gloster LJ ruled these were to be construed not merely as representations but

also as contractual warranties. She agreed with counsel that a breach would have occurred at the time the relevant NRAM loan agreement was entered into and limitation defences might be available to bar any claims for misrepresentation or breach of contractual warranty.

## What should lawyers do next?

With one very important exception, this ruling is very useful. It is very clear that where a lender uses CCA 1974 documentation for lending which is not regulated by CCA 1974, then it does not become regulated. In the present case, this meant that although there were technical defects in the statements NRAM had issued, it did not mean that CCA 1974, s 77A was engaged. This meant that NRAM did not have to pay compensation to those customers in the same way that it had had to do to customers who had borrowed £25,000 or less and whose loans were CCA 1974 regulated.

NRAM has correspondingly avoided a compensation bill of £258m to the UK taxpayer. Other lenders in a similar position will also not have to pay compensation.

Lending documentation perimeter issues arises (or has arisen) principally in two situations:

- secured second charge lending, and
- lending to unincorporated businesses

When CCA 2006 came into force in April 2008, the limit of £25,000 was abolished. This means that all secured lending to consumers will be regulated (unless they are high net worth individuals). The issue NRAM faced with its 'Together' loans is a diminishing one.

The issue with business lending remains with us. The effect of CCA 2006, s 16B is that lending of £25,000 or less to unincorporated businesses (sole traders or partnerships) is regulated. Lenders providing finance for vehicles or plant to these businesses face a choice. They can either have a dual suite of documentation--using one set for lending of £25,000 or less that is CCA 1974 regulated and a second set for greater amounts. Alternatively, if a lender uses just one set of documents, then the issue in relation to using CCA 1974 documents for SME business lending of over £25,000 that occurred in this case will re-occur.

In the end, Gloster LJ did not need to examine what a breach of warranty claim would look like and how much a lender could have to pay if it was made out. It is not clear whether a lender could exercise a right of set off for sums due to it under any loan agreement or would have to pay cash compensation instead. For consumer hire business there is the added complication that VAT is due on rentals.

*The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor*